

VZCZCXRO7837  
PP RUEHIK  
DE RUEHBS #1393/01 2891447  
ZNR UUUUU ZZH  
P 161447Z OCT 09  
FM USEU BRUSSELS  
TO RUEHC/SECSTATE WASHDC PRIORITY  
RHEHNSC/NSC WASHDC PRIORITY  
INFO RUCNMEM/EU MEMBER STATES COLLECTIVE  
RUCNMEU/EU INTEREST COLLECTIVE  
RUEHBJ/AMEMBASSY BEIJING  
RUEHBR/AMEMBASSY BRASILIA  
RUEHMO/AMEMBASSY MOSCOW  
RUEHNE/AMEMBASSY NEW DELHI  
RUEHOT/AMEMBASSY OTTAWA  
RUEHSA/AMEMBASSY PRETORIA  
RUEHKO/AMEMBASSY TOKYO

UNCLAS SECTION 01 OF 03 BRUSSELS 001393

SENSITIVE  
SIPDIS

NOT FOR INTERNET DISTRIBUTION

E.O. 12958: N/A  
TAGS: [EFIN](#) [ECON](#) [ETRD](#) [EIND](#) [EINV](#) [EUN](#)  
SUBJECT: EU Financial Supervisory Reform

BRUSSELS 00001393 001.6 OF 003

1. (U) SUMMARY: On September 23, the European Commission (EC) proposed new legislation to reform the European system of financial supervision at both macro and micro prudential levels. The proposals build on the Commission's May 2009 Communication and follow closely the Conclusions of the June ECOFIN Council, making it likely that they will move forward quickly. The EC proposes the creation of: --a European Systemic Risk Board (ESRB) to monitor and assess potential threats to financial stability, issuing risk warnings and, if necessary, recommendations for action; and --a European System of Financial Supervisors (ESFS), consisting of a network of national financial supervisors working in tandem with three new European Supervisory Authorities (ESAs) endowed with certain limited binding powers, to upgrade the quality and consistency of national supervision. European Systemic Risk Board (ESRB):

2. (U) The ESRB's main decision-making body will be the General Board, composed of the Governors of the national Central Banks of the EU, the President and the Vice-President of the European Central Bank (ECB), a Member of the European Commission and the Chairpersons of the three European Supervisory Authorities. National supervisors in the unanimous endorsement "y the EU 27 Leaders at the June European Council. This, and the fact that the new body will have no legal personality or binding powers, will make approval relatively easy. Possible limited disagreement could arise over the mechanisms to collect the micro-prudential information from the ESFS that will be crucial to the ESRB's ability to identify risks.

European System of Financial Supervisors (ESFS):

5. (U) The ESFS will function as a network of supervisors. It will be composed of the national supervisors of each Member State (who will maintain responsibility for day-to-day supervision of individual firms), the European Supervisory Authorities, and the European Commission (EC). A Joint Committee of European Supervisory Authorities will seek to ensure cooperation and consistent supervisory approaches between the three new ESAs, and will help deal with cross-sectoral issues (e.g. financial conglomerates). The new ESAs will be:

--the European Banking Authority (EBA);  
--the European Insurance and Occupational Pensions Authority (EIOPA); and  
--the European Securities and Markets Authority (ESMA).

6. (U) The main decision-making body of each ESA will be its Board of Supervisors responsible for the adoption of the draft technical standards, opinions, recommendations, and decisions. The Board will be composed of the Chair (independent and non-voting), the heads of the relevant national supervisors, and non-voting representatives of the Commission, the ESRB as well as the other ESAs. Decisions by

BRUSSELS 00001393 002.8 OF 003

1. (U) SUMMARY: On September 23, the European Commission (EC) proposed new legislation to reform the European system of financial supervision at both macro and micro prudential levels. The proposals build on the Commission's May 2009 Communication and follow closely the Conclusions of the June ECOFIN Council, making it likely that they will move forward quickly. The EC proposes the creation of: --a European Systemic Risk Board (ESRB) to monitor and assess potential threats to financial stability, issuing risk warnings and, if necessary, recommendations for action; and

--a European System of Financial Supervisors (ESFS), consisting of a network of national financial supervisors working in tandem with three new European Supervisory Authorities (ESAs) endowed with certain limited binding powers, to upgrade the quality and consistency of national supervision.  
European Systemic Risk Board (ESRB):  
-----

12. (U) The ESRB's main decision-making body will be the General Board, composed of the Governors of the national Central Banks of the EU, the President and the Vice-President of the European Central Bank (ECB), a Member of the European Commission and the Chairpersons of the three European Supervisory Authorities. National supervisors will also be part of the Board, but without voting rights. A nine-person Steering Committee will direct ESRB operations. It will be composed of the ESRB Chair (likely to be the ECB President) and Vice-Chair (a Governor of one of the 27 Central Banks, likely from the Bank of England), the ESA Chairs, a member of the European Commission, the President of the Economic and Financial Committee (EFC) and two additional members of the central banks (euro and non-euro).

the Board will be taken by simple majority, except for the setting of draft technical standards and guidelines, where qualified majority voting will be used.

17. (U) The ESFS will have four primary tasks:

i. Develop technical standards;

To establish a single EU rule book, the Authorities will develop draft technical standards in areas to be specified in the relevant sectoral legislation. The draft technical standards will be adopted by the Authority via qualified majority of the members of the Boards of Supervisors, and subsequently endorsed by the EC.

ii. Ensure the consistent application of Community rules;

The ESAs will be empowered to investigate behavior by national supervisory authorities considered to be diverging from existing Community legislation, recommend corrective action, refer the non-complying authority to the EC and, as a last resort, adopt a decision addressed directly to financial institutions.

iii. Action in emergency situations;

In crisis situations, the ESAs will coordinate national supervisory responses, and will have the power to require national supervisors to jointly take specific actions (e.g. short-selling restrictions, suspension of trading, etc.).

iv. Settlement of disagreements between national supervisory authorities;

In cases where conciliation between disagreeing supervisors proves unsatisfactory, the ESAs will have the power to settle disagreements by imposing binding decisions. The ESAs binding decision-making powers should be proportionate, and should not impinge on the fiscal responsibilities of Member States.

18. (U) Other tasks will include promoting the efficient functioning of Colleges of Supervisors: fostering a common supervisory culture: delegation of tasks and responsibilities and peer reviews; performing assessment of market developments; and ensuring an international and advisory role, as well as collecting information and interfacing with the ESRB. The European Securities and Markets Authority will also be given authority to register and supervise Credit Rating Agencies.

19. (U) These are far-reaching proposals and have created controversy. In the discussions leading up to the publication of the Commission's proposals, the two biggest hurdles have been balancing the interests of Euro-area Central Banks (represented by the ECB) and non Euro-area Central Banks in the ESRB and endowing the ESAs with binding decision-making powers. The first issue has been resolved by reserving the Vice-chairmanship of the ESRB for a non Euro-area Central Bank. It is widely assumed that the Vice-chairmanship will go to BoE Governor Mervyn King. The second issue has been overcome, at least temporarily, with an agreement on a "safeguard clause", limiting the ESAs binding decision-making powers to issues that do not interfere with the fiscal prerogatives

BRUSSELS 00001393 003.10 OF 003

1. (U) SUMMARY: On September 23, the European Commission (EC) proposed new legislation to reform the European system of financial supervision at both macro and micro prudential levels. The proposals build on the Commission's May 2009 Communication and follow closely the Conclusions of the June ECOFIN Council, making it likely that they will move forward quickly. The EC proposes the creation of: --a European Systemic Risk Board (ESRB) to monitor and assess potential threats to financial stability, issuing risk warnings and, if necessary, recommendations for action; and

--a European System of Financial Supervisors (ESFS), consisting of a network of national financial supervisors working in tandem with three new European Supervisory Authorities (ESAs) endowed with certain limited binding powers, to upgrade the quality and consistency of national supervision.  
European Systemic Risk Board (ESRB):  
-----

2. (U) The ESRB's main decision-making body will be the General Board, composed of the Governors of the national Central Banks of

the EU, the President and the Vice-President of the European Central Bank (ECB), a Member of the European Commission and the Chairpersons of the three European Supervisory Authorities. National supervisors will also be part of the Board, but without voting rights. A nine-person Steering Committee will direct ESRB operations. It will be composed of the ESRB Chair (likely to be the ECB President) and Vice-Chair (a Governor of one of the 27 Central Banks, likely from the Bank of England), the ESA Chairs, a member of the European Commission, the President of the Economic and Financial Committee (EFC) and two additional members of the central banks (euro and non-euro).

of the Member States.

10. (U) In order for the ESAs to successfully exercise their binding powers, the Commission will need to amend all the relevant sectoral directives (e.g. MiFID, UCITS, CRD, CRA, Solvency II), specifying the ESAs competences over the substance of financial services regulation and supervision. It is expected that some Member States will try to use this process to limit the reach of the ESAs new powers.

Outlook:

-----

11. (U) On October 14, the Member States' Permanent Representatives (COREPER) reached a tentative agreement on the ESRB package (the Regulation establishing the ESRB and the Decision concerning its functioning). The text, which is still not publicly available, introduces a few changes to the EC's proposal:

--Issuing Recommendations will require a higher number of votes than to issue Warnings; and

--The composition of the Steering Committee has been modified by raising the number of CB's from 2 to 5 (likely 3 Euro-area and 2 non Euro-area).

12. (U) The ESRB legislation is moving quickly and may receive a sign-off by Member States in Council by end-2009. The ESFS legislation, however, is more controversial and may not receive the Council's agreement before year-end. Both legislations need the European Parliament's assent to become effective, and the Parliament has already made it known that it will be physically unable to complete the procedure before early 2010, at the earliest.

MURRAY